Thailand Strategy

"When elephants fight, the grass gets hurt"...but not before a surge in investment

Equity Strategy

Asia

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Why Trump's Economic Plan matters for emerging markets such as Thailand
We have a blue print for new US Administration's economic policies. It was set out on 29 September 2016, in a paper authored by Peter Navarro and Wilbur Ross. The focus is on creating manufacturing jobs and reducing the US trade deficit. The paper attributes the loss of manufacturing jobs to push factors such as high taxes and heavy regulation and the pull factor of "unfair trade practice like the lure of undervalued currencies and the availability of illegal export subsidies". The paper states, "If, however, the [trade] cheating does not stop, Trump will impose appropriate defensive tariffs to level the playing field". IF they were to be imposed, it is hard to present this as anything other than negative for a relatively small, open economy such as Thailand, all other things being equal. Trade as a % of GDP exceeds 140%. However, we have been here before, and all other things are not necessarily equal.

We have been here before. In the 1980s, it resulted in a surge in investment
In the mid-1980s, similar to today, the US was running twin deficits. Even though the overall economy was very strong (real GDP growth in 1984 was a stellar 7%) it created problems for American manufacturers which struggled to compete. This ultimately resulted in the Plaza Accords in 1985. In 1985-87, the US dollar fell from 263 vs the Japanese Yen to 123. An unintended consequence of this was the surge in outsourcing by Japanese companies, which provided an enormous boost to growth in ASEAN. Inward FDI into ASEAN increased from US$1bn in 1985 to US$21bn by 1996. For Thailand, total investment increased from 27% of GDP to 42%, and for 10 years from 1986-96 Thailand was the fastest growing economy in the world. Could we see a repeat of the 1980s? History rarely exactly repeats itself but it does have a rhythm.

An acceleration in investment was quite likely anyway
Leading indicators of inward FDI from China have anyway been rising. The number of applications by Chinese companies for BoI applications have doubled over the past three years, and the number of Thai work permits issued to Chinese nationals have increased by 50% over the same period. For Japanese companies, the largest current source of inward FDI in ASEAN, in one recent survey 50% of respondents said they would consider risk diversification away from China into other countries and regions. One reason is wages. Based on data for 4Q16, the average annual salary for a manufacturing worker in China is 50% higher than Thailand and double the average for the 'VIP countries' (Vietnam, Indonesia and the Philippines). Notwithstanding whether we are right on FDI, we believe investment in Thailand would anyway have accelerated as the Thai government invests heavily in infrastructure to stimulate investment which has been largely moribund for the past 20 years. A key plank of its policy is the 'Eastern Economic Corridor' (EEC) initiative. We feature the details in this report. We believe you will read a lot about the EEC over the next 12 months.

Overweight investment sensitive stocks; underweight consumption
We are cautious on the outlook for the broad SET Index because of rising bond yields and current relatively low equity risk premium (our SET Index target of 1,580 is at the low end of consensus). However, we believe overweighting stocks which benefit from an increase in investment and relatively strong commodity prices can generate outperformance. And, if we are right on our thesis, we could see earnings upgrades which should boost gains. Our full list of most preferred names is: IRPC, Kasikornbank, PTT Public, Siam Cement, Sino-Thai Engineering, Supalai, TMB bank and Total Access.

On 29 September 2016, Peter Navarro and Wilbur Ross published a White Paper entitled "Scoring the Trump Economic Plan". Given the authors, the paper's comments on trade cannot be simply dismissed. Peter Navarro will lead the new White House National Trade Council and Wilbur Ross was recently confirmed as the new US Commerce Secretary.

A blue print for economic policies of the new US administration. Why we should all take it seriously

Trump's Economic Plan focuses on the critical role in the economy of manufacturing jobs. The White Paper states that "since the era of globalization, manufacturing as a percent of the labour force has steadily declined from a peak of 22% in 1977 to about 8% today". It blames this not on technology (it notes that the proportion of manufacturing jobs in Germany and Japan are still 20% and 17%, respectively), but on push factors of high taxes and heavy regulation and the pull factor of "unfair trade practice like the lure of undervalued currencies and the availability of illegal export subsidies."

The emphasis is on creating manufacturing jobs

The White Paper states: "A Trump Administration will not tolerate [trade] cheating by any nation. If America's trading partners continue to cheat, President Trump will use all available means to defend American workers and American manufacturing facilities from such cheating, including tariffs. Tariffs will be used not as an end game but rather as a negotiating tool to encourage our trading partners to cease cheating. If, however, the cheating does not stop, Trump will impose appropriate defensive tariffs to level the playing field."

If countries "cheat", President Trump will "impose appropriate defensive tariffs"

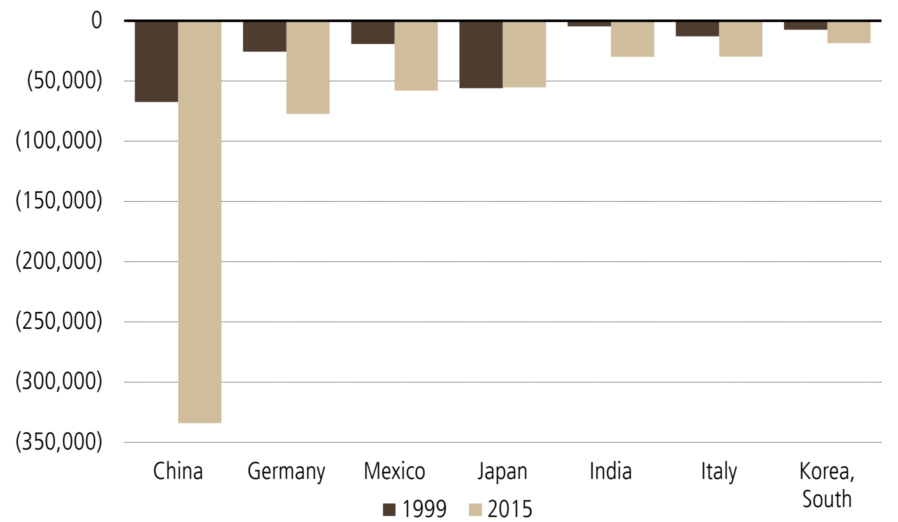
The White Paper argues that "Trump's goal is not to reduce overall trade flows but rather increase them. Through tough, smart negotiations, he will improve our trade deals, increase our exports, and displace some goods we now currently import with products made in America….Trump proposes eliminating America's $500 billion trade deficit through a combination of increased exports and reduced imports."

The goal is to eliminate the US's US$500bn trade deficit

The US currently runs trade deficits with a number of countries, but by some distance the largest – and the one which has shown the greatest deterioration since 1999, is with China.

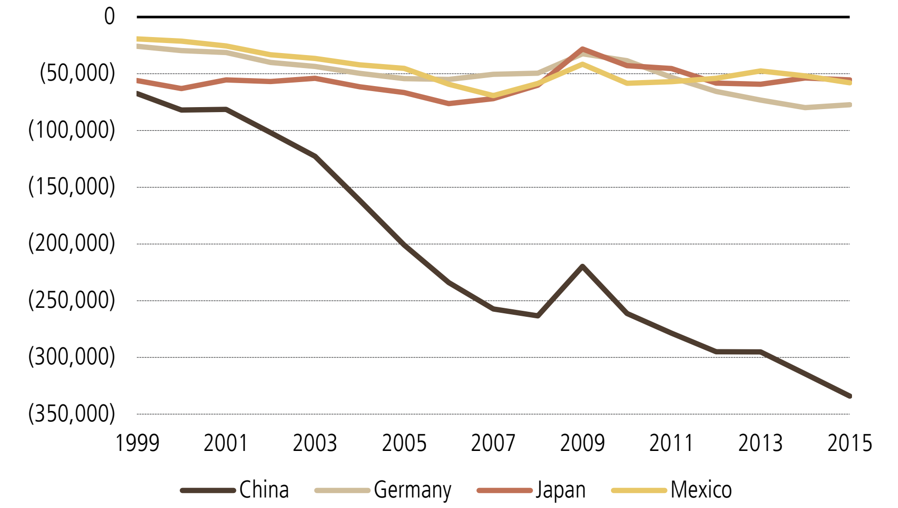
The US currently runs a trade deficit with China of approx. US$1bn per day

Figure 1: US balance on goods and services, by country 1999 & 2015 (US$m)



Source: US Bureau of Economic Analysis

Figure 2: US balance on goods and services, 1999 - 2015 (US$m)



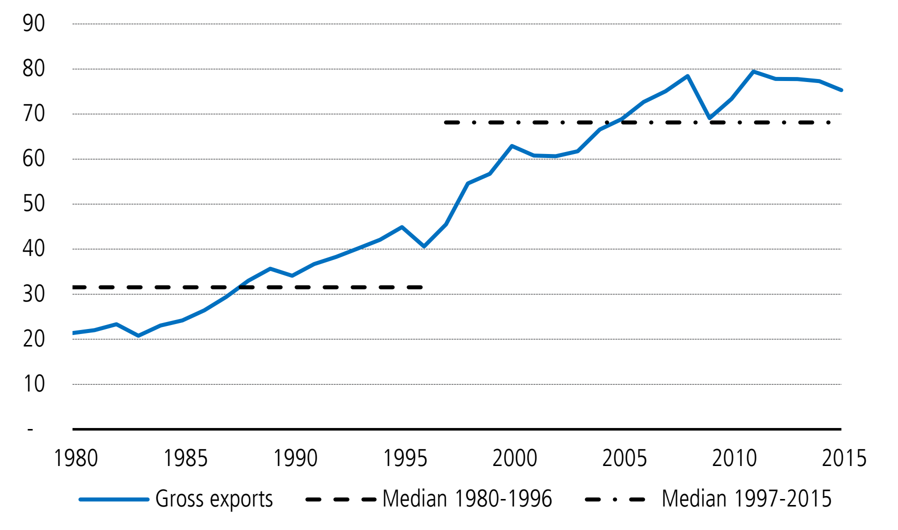
Source: US Bureau of Economic Analysis

Why Trump's Economic Plan matters for emerging markets such as Thailand

As a relatively small, open economy, Thailand stands to be negatively impacted by any reversal of globalisation. Gross exports as a % of GDP for Thailand for 2015 were 75%. The contribution has increased significantly compared to the period prior to the Asian financial crisis in 1997.

As a relative small, open economy, Thailand stands to be negatively impacted by any reversal of globalisation

Figure 3: Thai gross exports as a % of GDP (%)

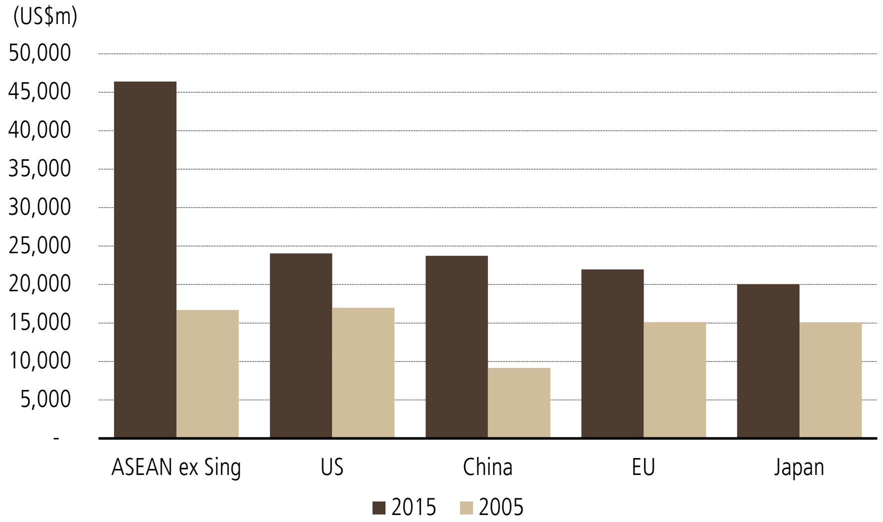


Source: CEIC, Haver, UBS

The destination for Thai exports has changed considerably over the course of the past 10 years, due to reduction in tariffs within ASEAN, rapid growth in neighbouring countries and increasing regional connectivity. One quarter of total Thai exports now go to ASEAN ex Singapore (we exclude Singapore because of the high proportion of goods which are re-exported; it is not reflective of actual end demand). For Thailand's other major trading countries and regions, the split of exports is relatively similar: 11% of Thai exports go to each of the US and China, 10% to the EU and 9% to Japan.

Thai exports are relatively diversified, with the largest % now into other ASEAN countries

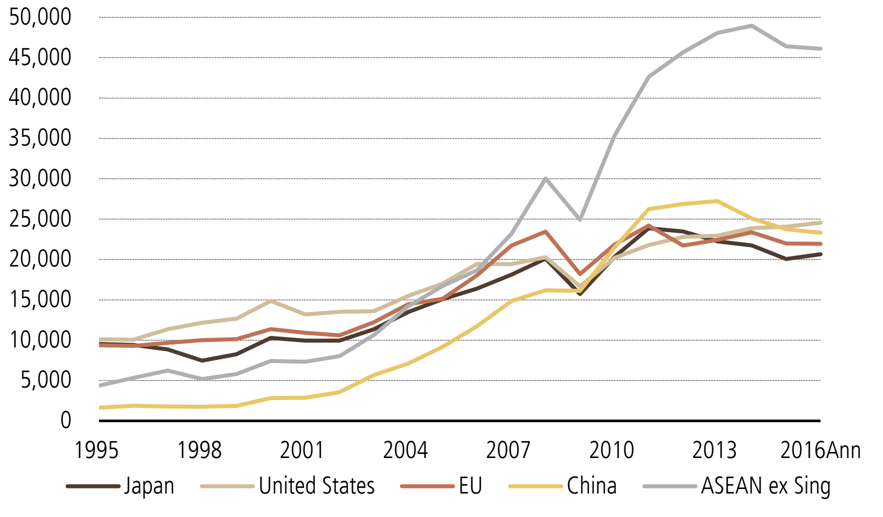
Figure 4: Thai exports classified by country, 2015 (US$m)



Source: Bank of Thailand, using data provided by the Thai Customs Department

Over the past five years, ex ASEAN, Thai exports in US$-terms to our major trading partners have been flat or falling, except for the US. Thai exports to the US have risen by approximately 20% over the past five years and are at an all-time high.

Figure 5: Thai gross exports, by country 1995-Nov 2016 (US$m)

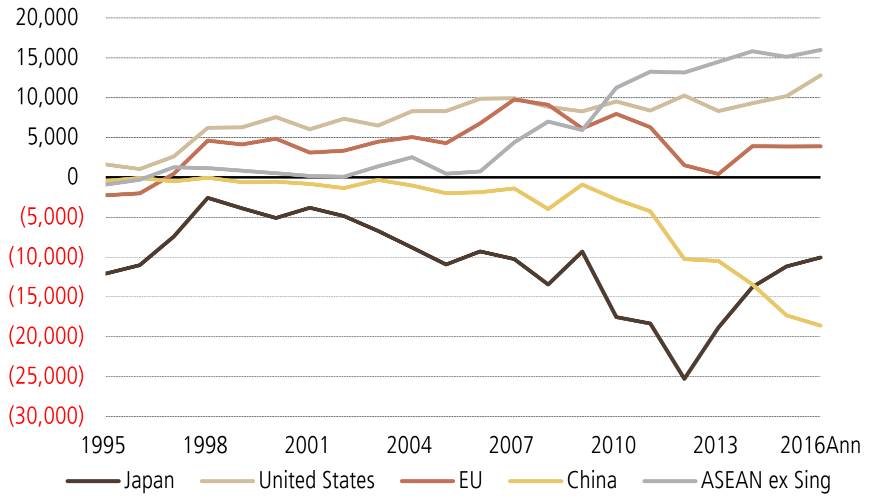


Source: Bank of Thailand, using data provided by the Thai Customs Department

However, Thailand does have a relatively large – and growing – trade surplus with the US

Thailand also has a significant - and growing - trade surplus with the United States. If we annualise data for the first 11 months of 2016, Thailand had a trade *surplus* of US$13bn with the United States. This compares to a trade *deficit* of US$19bn with China. Sino-Thai trade represents the single largest deficit Thai runs with any one country or region; historically it had always been Japan.

Figure 6: Thai trade balance, by country 1995-Nov 2016 (US$m)



Source: Bank of Thailand, using data provided by the Thai Customs Department

Thailand's largest exports to the US are hard disc drives, followed by rubber products and jewellery. Vehicles and parts rank fifth.

Figure 7: Thailand's largest exports to the US, 2013-2016 (US$m)

	2013 (US$m)	2014 (US$m)	2015 (US$m)	2016 (US$m)	% share (%)	YoY growth (%)
Automatic data processing machines and parts	4,230	4,503	4,910	4,893	20%	-0.3%
Rubber products	1,557	1,541	1,702	1,969	8%	15.7%
Precious stones and jewellery	1,320	1,360	1,310	1,259	5%	-3.9%
Radio-broadcast receivers, television receiver and parts	1,027	1,412	1,552	1,050	4%	-32.4%
Motor cars, parts and accessories	434	629	672	888	4%	32.0%
Prepared or preserved fish, crustaceans, molluscs	1,181	1,119	920	864	4%	-6.1%
Articles of apparel and clothing accessories	1,018	1,000	953	850	3%	-10.9%
Prepared or preserved fruits	553	585	698	766	3%	9.7%
Electronic integrated circuits	664	635	637	702	3%	10.1%
Machinery and parts thereof	595	671	821	697	3%	-15.1%
Teleprinters, telephone sets and parts	810	616	553	600	2%	8.4%
Other electrical equipment and parts	689	619	617	587	2%	-4.9%
Iron and steel and their products	430	424	485	532	2%	9.7%
Semi-conductor devices, transistors and diodes	31	27	75	484	2%	541.7%
Fresh, chilled or frozen shrimps, prawns and lobster	365	314	261	429	2%	64.3%
Plastic products	345	382	374	392	2%	4.9%
Rice	457	446	411	376	2%	-8.4%
Air conditioning machines and parts	265	334	286	302	1%	5.5%
Rubber	417	301	252	277	1%	9.9%
Spark-ignition reciprocating internal combustion engines	208	204	232	273	1%	17.7%

Source: Information and Communication Technology Centre, with Cooperation of The Customs Department

The data only captures direct exports to the US of 11%. There are obviously significant indirect exports. In a recent conversation with a government official, he suggested the total value of Thai exports (direct and indirect) could be 22%. In addition to this, Thai exports to other countries would obviously also be impacted if we witnessed a slowdown in demand due to weak global trade.

Total Thai exports to the US (direct and indirect) are estimated to be approx. 22%

In short, it is hard to present a trend towards rising protectionism as anything other than ultimately negative for an open-economy such as Thailand. However, history teaches us that it can also lead to positive mitigating factors, at least in the near-term.

The world has been here before. In the 1980s, it resulted in the Plaza Accords

The White Paper itself makes reference to the fact that Trump' Economic Plan has been accused of being protectionist. There are echoes of the protectionist rhetoric in the 1980s which ultimately led to the Plaza Accords. The Accords were so-called because the deal was signed at the Plaza Hotel in New York in September 1985.

The White Paper itself makes references to accusations of protectionism…

In the mid-1980s, similar to today, the US was running twin deficits, fiscal and current account. Even though this was contributing to relatively strong growth for the US economy overall (US GDP had expanded by 7% in real terms in 1984), it was creating problems for American manufacturers who were struggling to compete.

…We have been here before. It resulted in the Plaza Accords in 1985.

By 1985, the US current account deficit expanded to US$161bn, or 3.3% of GDP. The group of five industrialised nations agreed to allow the US dollar to depreciate against the Japanese Yen and the Deutsche Mark. The dollar had been depreciating anyway, but coordinated central bank intervention accelerated this trend. Between February 1985 and December 1987, the USDYEN declined from 263 to 123. The dollar also depreciated against the Deutsche Mark and Sterling. Whilst the US continued to run a trade deficit with Japan, the overall US trade deficit was eliminated by 1991.

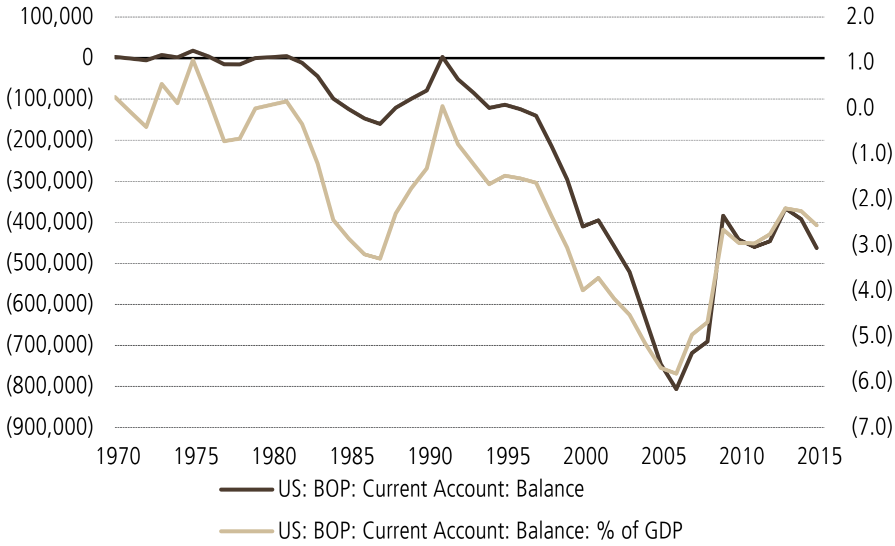
Figure 8: USDYEN 1980-1989

Source: Bloomberg

However, since 1991, the US trade deficit has expanded again, and at US$460bn for 2015 it is considerable larger than at the time of the Plaza Accords in 1985. Albeit, relative to GDP, the deficit is narrower (at 2.6%) and is significantly narrower than 2006, when the US trade deficit was US$807bn. Thus, here we are again.

This was successful in eliminating the US's trade deficit, only for it to expand again due to globalisation

Figure 9: US trade balance in goods and services, 1970-2015 (US$m)



Source: US Bureau of Economic Analysis

How the Plaza Accords were the catalyst for an investment boom in ASEAN

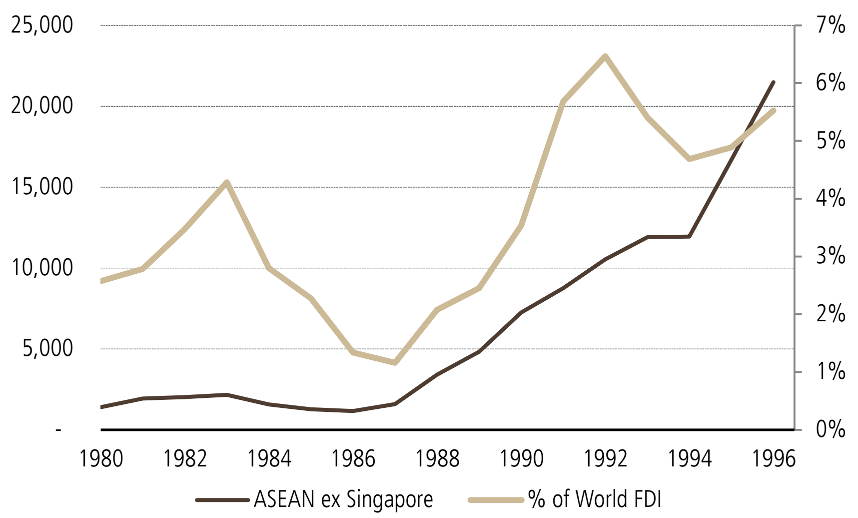
An unintended consequence (we presume) of the Plaza Accords was the surge in outsourcing by Japanese companies, which provided an enormous boost to growth in ASEAN. It ultimately, and abruptly, ended in 1997, but not before millions had been raised out of poverty, new industries emerged and asset prices rose sharply.

An unintended consequence of the Plaza Accords was an investment boom in Thailand and ASEAN

Inward FDI into ASEAN ex Singapore rose from US$1bn in 1985 to US$21bn by 1996, immediately prior to the Asian Financial crisis. As a % of global inward FDI, it peaked in 1992 at 6.5%. (We exclude Singapore because many companies divert FDI via subsidiaries in Singapore and therefore to include it would be double counting).

FDI into ASEAN (ex Singapore) grew from US$1n in 1985 to US$21bn by 1996

Figure 10: Inward FDI into ASEAN ex Singapore, 1980-1996 (US$m)

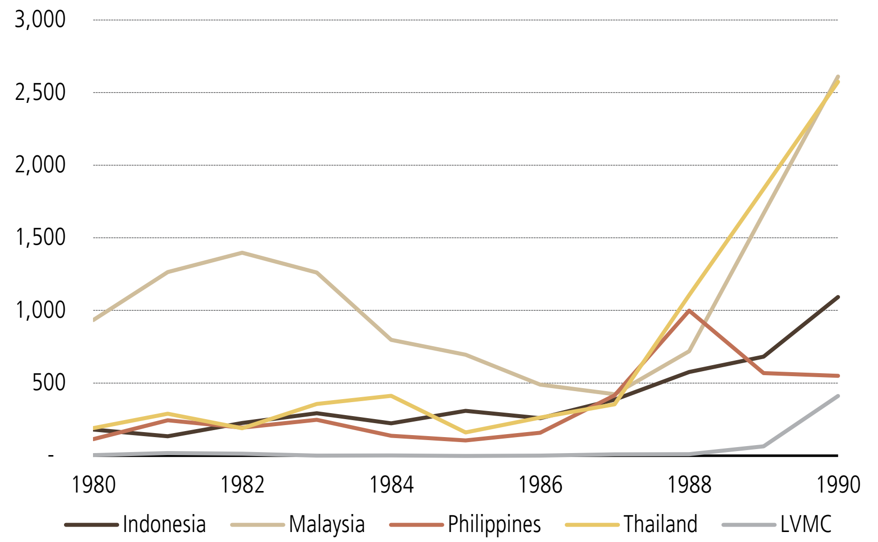


Source: IMF, UBS

Initially, Thailand and Malaysia were the largest beneficiaries…

Initially, Thailand and Malaysia were the largest beneficiaries of this inward investment. This changed in the 1990s but it the meantime it proved to be the catalyst for a broad acceleration in investment.

Figure 11: Inward FDI into ASEAN, by country 1980-1990 (US$m)



Source: IMF

…This was the catalyst for a broad surge in investment

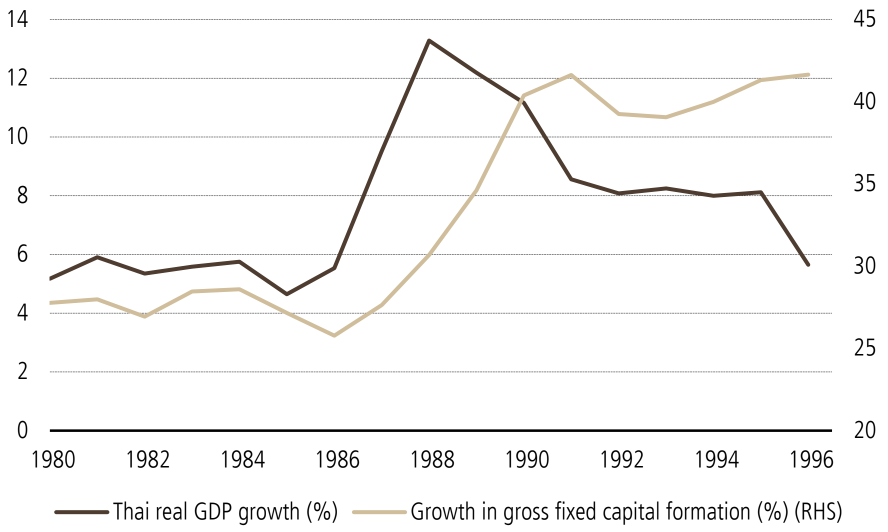
Thai gross fixed capital formation as a percentage of GDP rose from 27% in 1985 to 42% in 1991. From 1985 up until 1996, Thai real GDP growth averaged 9%. The peak was 13% in 1988.

Due to both global and Thai-specific factors, we are *not* expecting a surge in investment or growth of a similar magnitude. Thailand is more mature now, the country is older (the median age is now 38), leverage is much higher and there is excess capacity in a number of industries (both locally and globally).

However, we argue it *is possible* for a shift in the share of FDI between China and ASEAN (it was starting to happen anyway). And together with significant planned infrastructure spending (the largest in a generation) we can see a recovery in investment, which has been generally moribund for most of the past 20 years.

We are not expecting a repeat of the excesses of 30 years ago, but we do believe some acceleration in investment is likely

Figure 12: Thailand growth in GDP and investment, 1980-1996 (%)



Source: World Bank

The pivotal question: could history repeat itself, albeit on a more modest scale?

To the extent that China runs the largest trade surplus with the US (in excess of US$1bn per day) and to the extent that the aforesaid White paper singles out China on trade, we restrict ourselves to focussing on the possibility of a shift in FDI flows from China to ASEAN. This could either be Chinese companies investing overseas or multinational companies from third party countries (e.g. Japan) who choose to favour manufacturing in ASEAN instead of China.

We focus on the impact of change in China because that is where the White Paper focuses

Firstly, to directly address the experience in 1985-87, is there any evidence that the Chinese authorities would agree to a sudden and large re-valuation of their currency the way Japan did? To date, we would argue no. In fact, over the past three years, the Chinese Yuan has been depreciating versus the US dollar, unwinding approximately half of the appreciation we had witnessed in 2005-2014.

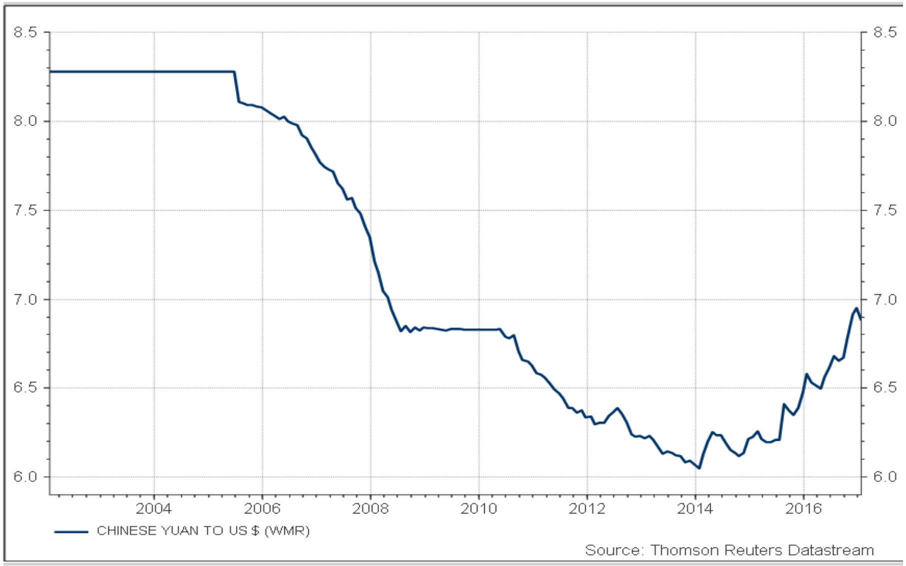
There is no evidence that China is prepared to let its currency appreciate; if anything, the recent evidence is the reverse

Baring a surprising piece of negotiation by the new US administration, we are not expecting this to change. This represents a key difference from the 1980s. UBS's forecast is for this trend to continue, with the Yuan gradually depreciating to 7.3 vs the US dollar at the end of 2017 and 7.5 at the end of 2018.

However, the White Paper floats the possibility of imposing 'defensive tariffs" if countries are guilty of currency cheating. This could have a similar effect as an appreciation in the value of the currency. We have no way of knowing if this is ever likely to happen. However, if the weight of evidence suggests that the probability is sufficiently high (we question how high is high enough?) then it could still have an impact on investor behaviour.

What about the prospects for "defensive tariffs' which could alter the competitiveness of Chinese manufacturing?

Figure 13: Chinese Yuan vs the US$ 2002-2017

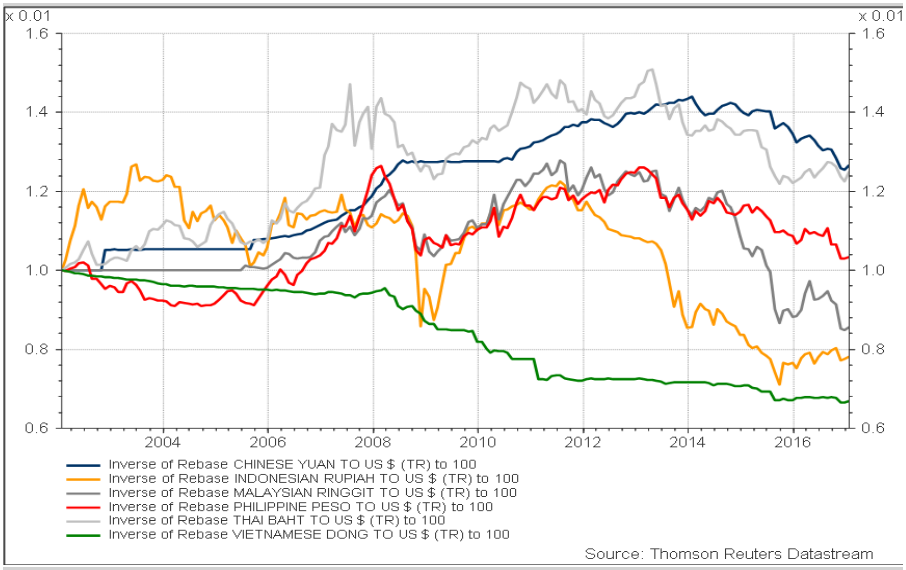


Source: Thomson Reuters Datastream

Even in the absence of both these factors, the Yuan has *already appreciated* against most peers in ASEAN over the past 3 years

Notwithstanding whether the Chinese Yuan appreciates against the US dollar or not, it has already appreciated against most alternative manufacturing centres in ASEAN over the past 15 years. The greatest appreciation has been versus the Indonesian Rupiah and the Vietnamese Dong. The exception is Thailand. We believe this is because the Thai current account has benefitted from the rapid growth in Chinese tourists to Thailand. Since 2009, their number has increased from 800,000 to 9m.

Figure 14: ASEAN currencies and the Yuan vs. the US$ (rebased in 2002)

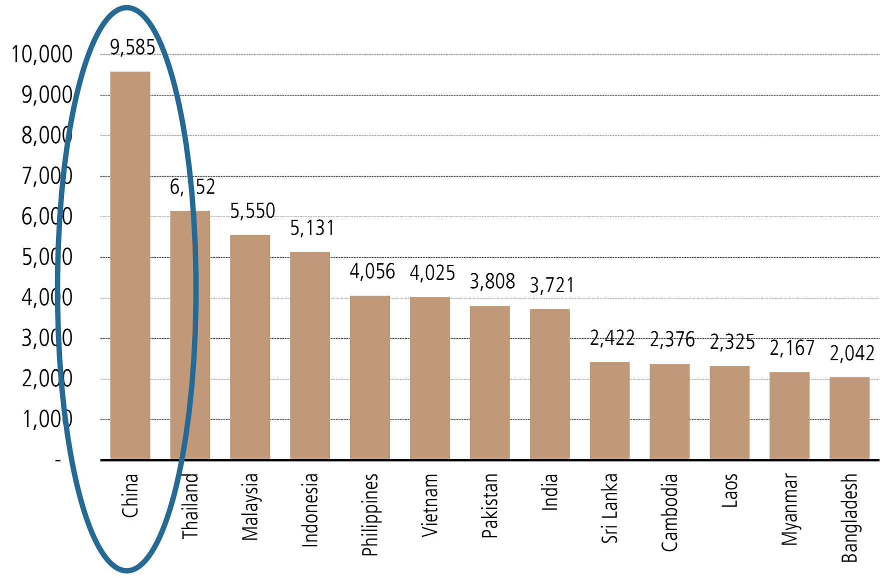


Source: Thomson Reuters Datastream

Together with wage inflation, Chinese labour is now twice as expensive as Vietnam and 50% more than Thailand

In addition to currency movements, wage inflation over the past 15 years has contributed to significant wage differentials. Compared to a number of alternative manufacturing locations, wages in China are no longer cheap. In fact, average wages for a manufacturing worker in China are higher than most Asian emerging economies, and double than those in Indonesia, Philippines and Vietnam. This is based on a survey of 4,600 Japanese companies.

Figure 15: Average cost of a manufacturing worker, 4Q16 (US$/year)

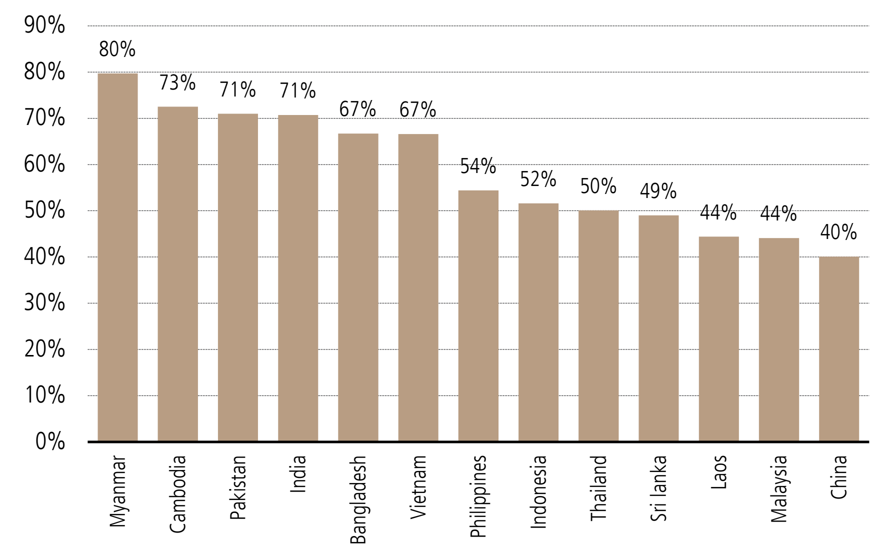


Source: Japan External Trade organization, based on a survey of 4,600 Japanese multinationals This survey was conducted during 11 Oct 2016 – 11 Nov 2016

This is reflected in Japanese companies' low propensity to expand in China

The same Japanese companies were asked about intentions to expand in the next 1-2 years. They responded that they were most likely to expand in Myanmar and Cambodia (albeit from a low base). They were least likely to expand in China.

Figure 16: The % of Japanese companies surveyed currently operating in one or other Asian countries which expected to expand over the next 1-2 years (%)



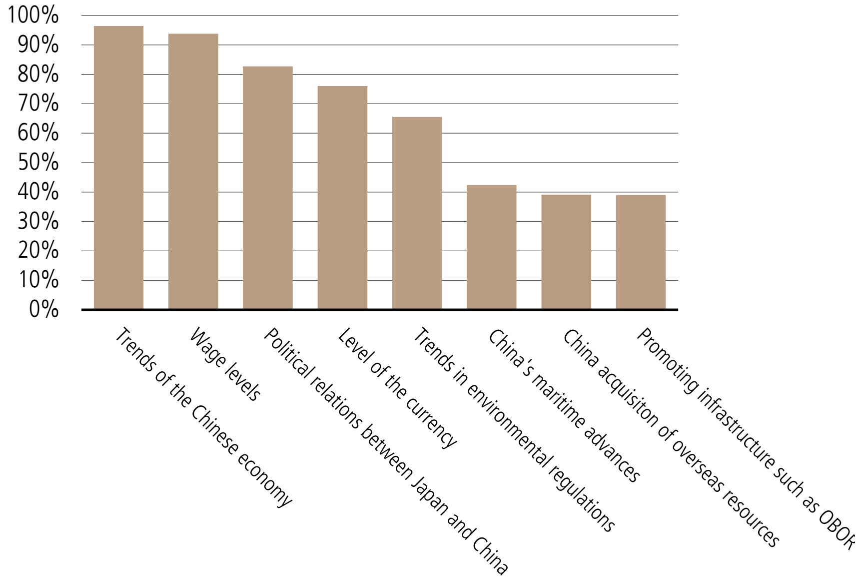
Source: Japan External Trade organization, based on a survey of 4,600 Japanese multinationals This survey was conducted during 11 Oct 2016 – 11 Nov 2016

90% of Japanese companies surveyed were concerned by the trends in the Chinese economy and wage levels

The numbers above are from a survey conducted by the Japanese External Trade Organization (JETRO) on business conditions for Japanese companies operating in Asia. There was another survey conducted around the same time by the Japan Bank for International Cooperation (JBIC) on overseas operations by Japanese manufacturing companies globally. One of the questions this survey addresses is the outlook on China and the stance towards future business operations. When

the manufacturers were asked about the outlook in China, more than 90% responded they were concerned by trends in the Chinese economy and wages.

Figure 17: Concerns of Japanese manufacturers towards China

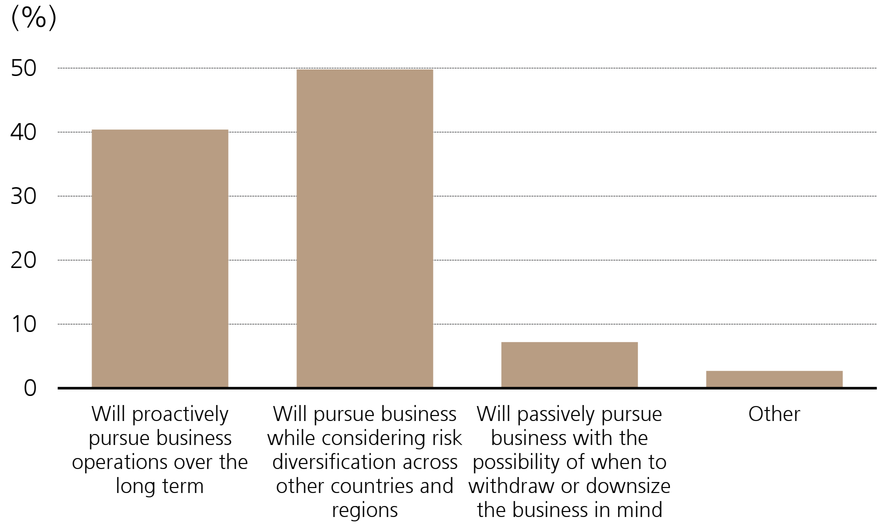


Source: Japan bank for International Cooperation, Survey report on Overseas Business Operations by Japanese Manufacturing Companies, FY2015 survey

50% of companies surveyed said they were considering risk diversification to other countries or regions

When asked whether they would consider risk diversification across other countries, 50% responded they would. This highlights a key argument; it is not just the intention of Chinese companies which could direct future inward FDI towards ASEAN; it is also companies from other countries which either are already operating in China and are considering relocating some or all of their operations, or companies which are choosing where to set up new manufacturing facilities and would otherwise have gone to China but may now consider alternative locations.

Figure 18: Japanese manufacturers stance towards future business operations in China



Source: Japan bank for International Cooperation, Survey report on Overseas Business Operations by Japanese Manufacturing Companies, FY2015 survey

Even if companies were considering either alternative manufacturing locations to China, how do other Asian emerging and frontier economies compare? In the aforesaid JBIC survey, companies were asked to identify where poor infrastructure was a hindrance to doing business. Malaysia and Thailand actually ranked ahead of China (where airports were the biggest impediment). Conversely, the frontier economies of Bangladesh, Cambodia, Laos, Myanmar, Pakistan and Sri Lanka ranked poorest. In between were Philippines, Indonesia and Vietnam (the 'VIP countries').

We believe superior infrastructure in Thailand and Malaysia mitigates cheaper wages in the 'VIP countries'

Figure 19: Assessment of infrastructure in Asia. The proportion of respondents who identified problems as a hindrance to doing business in the respective countries (%)

	Infrastructure problems are a hindrance to doing business						
	Electricity (%)	Indus. Water (%)	Roads (%)	Railways (%)	Ports (%)	Airports (%)	Weighted avg. (%)
Malaysia	-	0.7	-	1.4	-	19.9	**2.0**
Thailand	0.6	1.0	2.3	2.1	0.7	14.9	**2.2**
China	4.0	2.0	1.0	0.8	2.6	19.7	**4.0**
Philippines	4.4	1.9	5.3	3.1	17.1	37.0	**7.3**
Vietnam	8.1	4.0	9.0	4.3	3.3	29.1	**7.8**
Indonesia	6.8	2.4	21.0	7.1	11.8	29.6	**8.9**
India	24.1	9.5	17.1	6.6	7.5	37.2	**16.9**
Sri Lanka	33.3	20.8	16.0	28.6	17.4	58.3	**28.1**
Cambodia	42.1	22.6	22.2	23.3	18.8	51.6	**31.2**
Myanmar	55.8	27.0	29.3	22.9	20.5	48.6	**37.7**
Laos	55.6	33.3	33.3	30.4	26.1	52.4	**41.5**
Pakistan	54.2	38.1	38.1	38.9	30.0	47.6	**43.7**
Bangladesh	72.0	45.0	45.5	44.4	35.0	42.9	**53.0**

Source: Japan bank for International Cooperation, Survey report on Overseas Business Operations by Japanese Manufacturing Companies, FY2015 survey, UBS
Note: The weighted score was calculated by UBS. We assigned a 33% weighting to each of electricity, water and transport.

The recent experience suggests a growing number of Chinese companies are *already* looking to Thailand and ASEAN

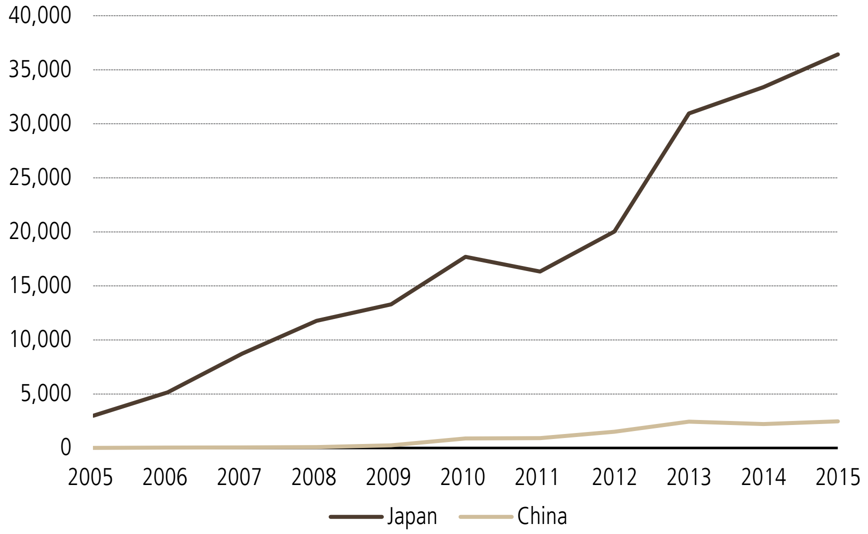
However, regardless of whether the Chinese currencies appreciates, or whether the new US administration decides to impose punitive tariffs on China, there is evidence that a growing number of Chinese companies are already investing in Thailand and ASEAN.

There is evidence that a growing number of Chinese companies are already turning to Thailand and ASEAN, albeit from a low base

We increasingly detect this from our meetings with local management. Ticon, which has developed one of Thailand's largest networks of factories for rent recently commented that of their new tenants in 2016, 40% were either from China or Taiwan. This compares to less than 10% in 2014-15 and the total outstanding tenant mix of only 3%.

To date, foreign direct investment (in value terms) from China still lags far behind that of Japan. However, in terms of the recent applications for BoI tax applications, and in the growing numbers of work permits issued to Chinese nationals we believe that the value of inward FDI from Chinese companies is likely to continue rising sharply in the coming years.

Figure 20: Cumulative FDI to Thailand from China and Japan, 2005-2015 (US$m)

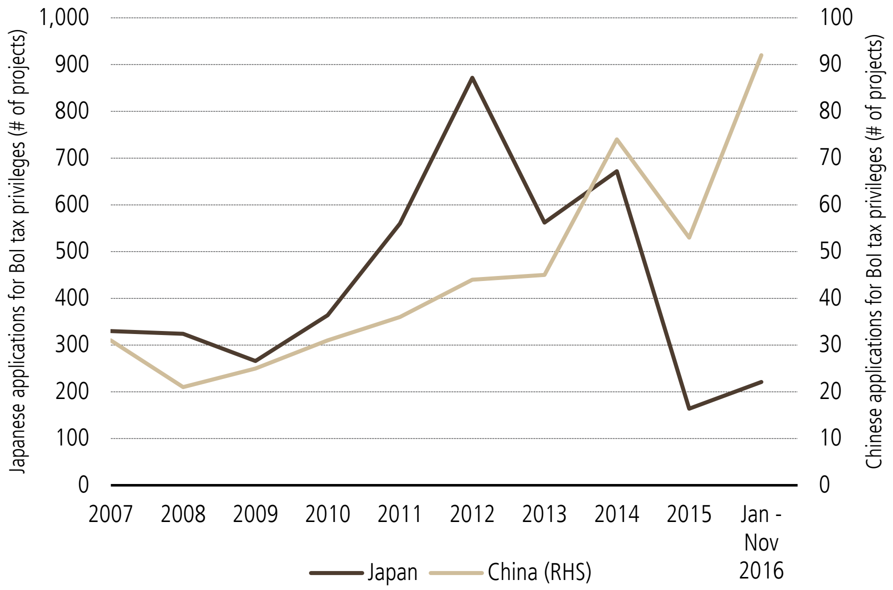


Source: The Bank of Thailand

Applications for BoI tax privileges have doubled over the past five years…

The number of applications by Chinese companies to the Thai Board of Investment for tax privileges has been trending higher for the past 10 years. However, it is from a very low base and today, the number of applications by Japanese companies is still more than double that for Chinese firms. The projects also tend to be larger, by investment value.

Figure 21: Applications to the Thai BoI for tax privileges by Chinese and Japanese companies (# of projects)

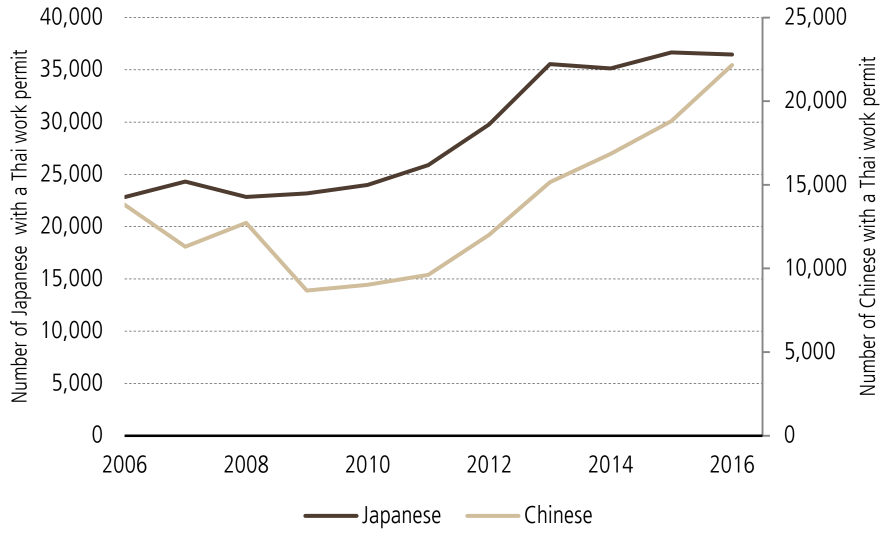


Source: Thai Board of Investment

…As have the number of Chinese with Thai work permits

The number of Japanese nationals with Thai work permits has been relatively stable over the past three years. Contrast this with work permits issued to Chinese nationals, it has risen by almost 50% over the same period.

Figure 22: Number of foreign nationals approved for work permit (number as of December each year)



Source: Thai Ministry of labour, Office of Foreign Workers Administration

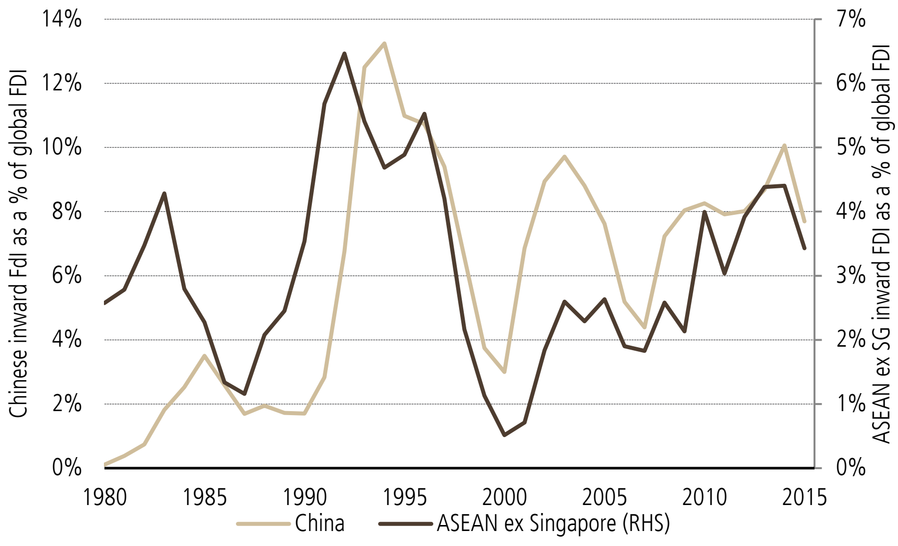
One caveat

To date, inward FDI into China and ASEAN, whilst different in scale appears to be correlated in recent years. The question is therefore, can inward FDI into ASEAN rise whilst that into China is flat or falling?

The above is all well in theory, but can the trend in ASEAN FDI de-couple from China? We are still waiting to see

We believe it requires change, and that is why we think it is topical to discuss this question now. Firstly, the incoming US administration already appears to be substantially different in approach to previous, recent administrations. Secondly, geo-politics beyond Sino-US relations; this is evidenced from the survey of Japanese companies above (80% of respondents cited Sino-Japanese politics as a concern). Thirdly, because of the establishment of the single ASEAN Economic Community, with more than 600m potential consumers and a growing middle class. Finally, because of the change in relative cost of doing business in China.

Figure 23: Inward FDI into China vs ASEAN ex Singapore



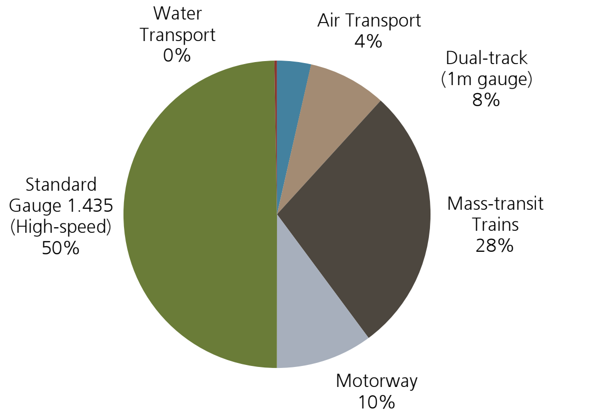
Source: UNCTAD

Beyond the impact on manufacturing, inward investment could provide a boost for infrastructure and the property sector

On 13 December 2016, Thailand's cabinet approved a new infrastructure action plan, 'the 2017 Action Plan'. The new Plan consists of 36 projects worth Bt896bn, all in addition to those in the 2016 Plan. This Plan details projects that are to be initiated in 2017, but not necessarily completing them in 2017. The Action Plan anticipates that all 36 projects should be completed within eight years.

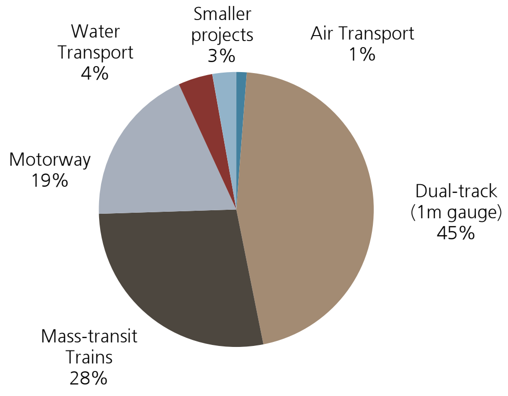
Other factors which should support growth in investment include unprecedented infrastructure spend

Figure 24: 2016 Action Plan worth Bt1,400bn



Source: Ministry of Transport, UBS

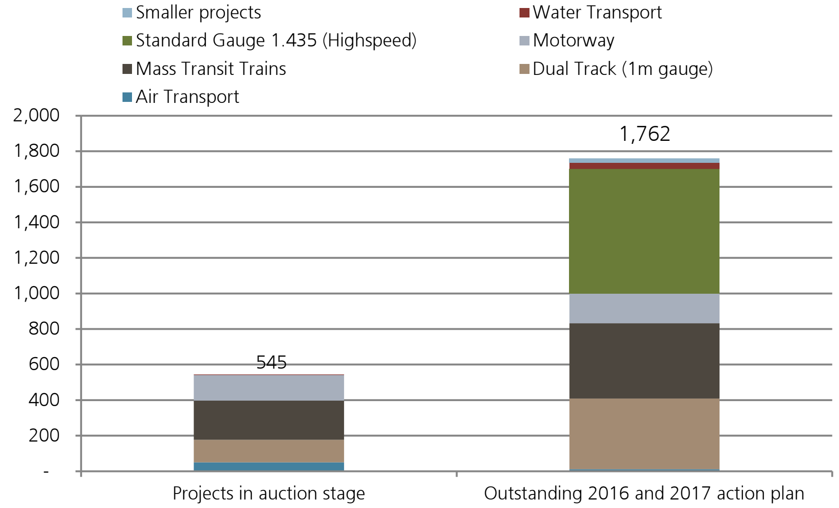
Figure 25: 2017 Action Plan worth Bt896bn



Source: Ministry of Transport, UBS

Of the 2016 Action Plan 15 projects out of 20 approved have already been approved. In addition, 14 of them, worth 545bn, have entered the auction phase. The outstanding projects from 2016 (four high-speed train projects, the purple and red mass-transit line projects) combined with the 2017 Action Plan projects should create Bt1,762bn worth of projects over the next eight years. This is more than a two-fold increase, the total remaining projects are equivalent to 13% of 2016E GDP.

Figure 26: Combining 2016 and 2017 Action Plans

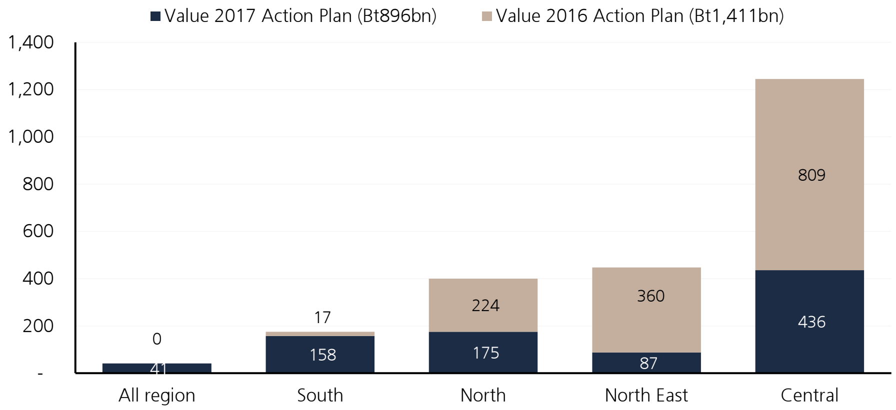


Source: Ministry of Transport, SRT, MRTA, UBS estimates

In addition, we analysed which regions would benefit in the long term from direct infrastructure spending. Bangkok and the vicinity should be the largest

beneficiaries from an increase the mass-transit network. However, we also see significant sums being disbursed into the North-eastern and Northern regions of Thailand, particularly in terms of rail transport investments.

Figure 27: Investment by region (Bt bn)



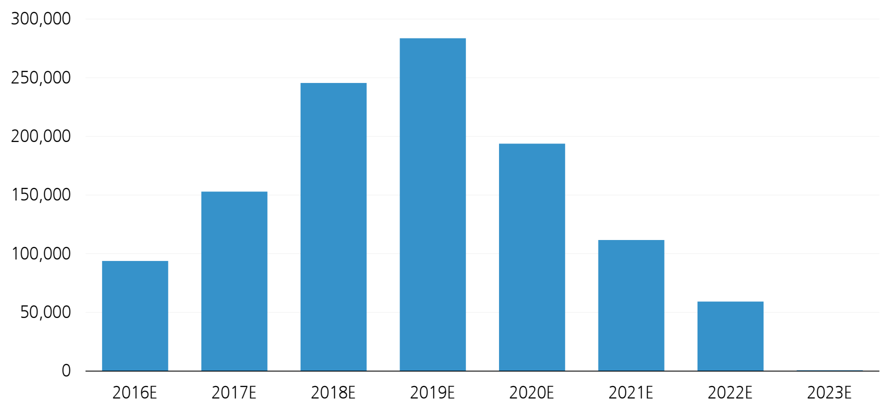
Source: Ministry of Transport, SRT, MRTA, UBS estimates

Government disbursements – what should we expect?

From the new Action Plan, we include three mega-projects into our forecast. Even though this may fall short of government expectations, we think this is significant enough to boost infrastructure spending when combined with the projects from 2016. We estimate total spending will be equal to 8% of 2016E GDP and 4.6x of the combined 2015 backlog of the four largest industrial contractors. We forecast incremental spending of Bt153bn and Bt246bn for 2017 and 2018, respectively. This is a big boost when compared with public construction spending in 2007-2014, which ranged from Bt440bn to Bt499bn per annum.

By analysing each mega-project, together with our checks, we have built a revised timetable for government disbursements based on what we thought was the most realistic timetable given the practical constraints. We estimate that over the next eight years the government could execute 40% of the total planned new mega-projects, the sum of the 2016 and 2017 Action Plans. Nevertheless, there will be a contribution from on-going projects that predate 2015.

Figure 28: Incremental infrastructure investment spending forecast ((Btm)



Source: MOT, MRTA, SRT, CK, UBS

Figure 29: New and old project spending in Bt m

Btm	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	Total
Existing projects	58,096	58,739	54,085	34,992	6,735	-	-	-	212,646
New projects	35,793	94,128	191,487	248,615	187,056	111,629	59,132	611	928,451
Total	93,889	152,867	245,572	283,607	193,791	111,629	59,132	611	1,141,097
% chg from previous	*-0.5%*	*-2.8%*	*5.9%*	*10.9%*	*7.5%*	*-4.3%*	*-20.2%*	*0.0%*	*2.7%*

Source: MOT, MRTA, SRT, CK, UBS

What we have not factored into our estimates is any contribution from the four proposed high speed railways under the 2016 Action Plan. Two of these were anticipated to be government-to-government agreements. The largest of which would be a more than 800km railway from Bangkok to the border with Laos, linking up with another route China is constructing through Laos which should eventually provide a seamless, rapid rail connection between Thailand and China. Progress has been slow but the Thai government continues to insist that this project will proceed. The Chinese capital may yet have a significant role to play in this investment

Thailand is still negotiating with china over the construction of a first high-speed train

Figure 30: 2016 Action Plan

	Gvt 20 project '2016-2017 Immediate Action Plan'	Bt bn	Approved	Auction phase
	Air Transport	**50**		
1	Suvharnabhumi Airport expansion	50	✓	✓
	Dual Track (1m gauge)	**116**		
1	Jira - Konkaen	24	✓	✓
2	Mapkabao - Jira	30	✓	✓
3	Nakorn Pathom - Huahin	20	✓	✓
4	Prachuab Krikun - Chumporn	17	✓	✓
5	Lopburi - Paknampo Project	25	✓	✓
	Mass Transit Trains	**396**		
1	Orange Line Project: Cultural center - Minburi	110	✓	✓
2	Pink Line Project: Kaerai - Minburi	57	✓	✓
3	Yellow Line Project: Lad Prao - Samrong	55	✓	✓
4	Light & Dark Red Line Project	44	✓	
5	Purple Line (South) Tao Poon - Ratchaburana	131		
	Motorway & Expressway	**144**		
1	Pattaya - Maptaput	18	✓	✓
2	Bang Pa In - Saraburi - Nakornrachasima	77	✓	✓
3	Bang yai - Karnchanaburi	49	✓	✓
	Standard Gauge 1.435 (Highspeed)	**701**		
1	Bangkok -Nakornrachasima (Thai - Chinese railway)	230		
2	Bangkok - Pitsanulok (Chiang Mai Thai Japanese railway)	224		
3	Bangkok - Huahin	95		
4	Bangkok - Rayong	153		
	Water Transport	**4**		
1	Laem Chabang Port A	2	✓	✓
2	Train transport link Laem Chabang Phase 1	2	✓	✓
	Total 20 Projects	**1,411**	**75%**	**70%**

Source: Ministry of Transport

Trends we discuss here sit well with Thailand's new, great hope for the future – the Eastern Economic Corridor

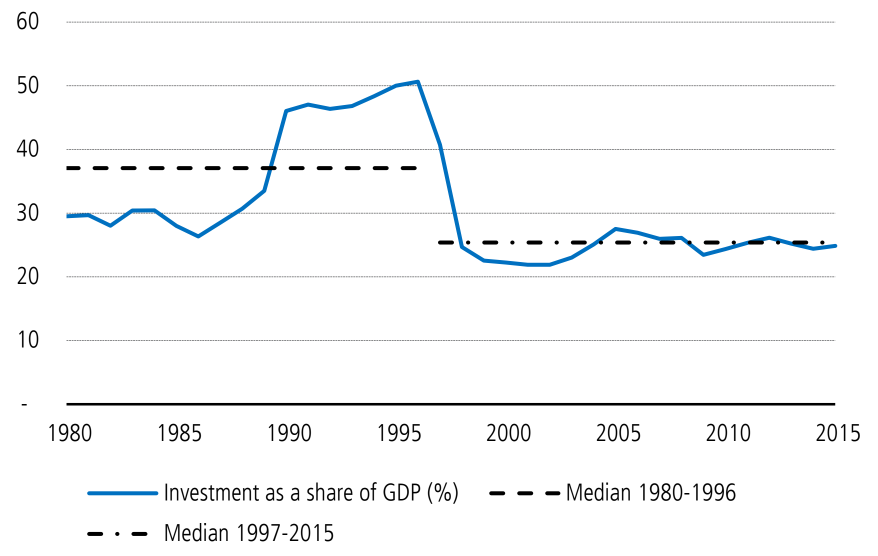
The topics we have discussed here – namely the outlook for foreign direct investment and infrastructure spend – complement the government's biggest initiative to "move Thailand forward". This is the name given to a package of policy initiatives designed to achieve Thailand's full growth potential despite challenges from negative demographics and increasing competition from newly emerging ASEAN countries such as Vietnam.

A bold new industrial policy! Arguably the first since the early 1990s

The centre piece of the government's programme is the Eastern Economic Corridor (EEC). If it is successful, it could boost both private and public investment spend, something successive governments have been unable to do since the Asian Financial Crisis 20 years ago.

The aim to kick start investment which has been moribund for the past 20 years

Figure 31: Thailand total gross fixed capital formation as a % of GDP



Source: CEIC, haver, UBS

The EEC is envisaged as a giant Special Economic Zone (SEZ) encapsulating three provinces to the east of Bangkok, Chachoengsao, Chon Buri and Rayong. What differentiates this SEZ from previous initiatives is 1) that it builds upon infrastructure which already exists and 2) the involvement of the private sector at an early stage. The government has reached out to both leading Thai and global companies to provide a platform which is fit-for-purpose.

We believe the EEC makes sense. It builds on what already works and the government has actively engaged with the private sector

What already exists in the EEC

- The EEC includes 21 functioning industrial estates ready for investment (covering more than 2,300 hectares) and there are six more under construction.
- The EEC is already home to significant industry clusters in automotive, electronics and petrochemicals, and almost 4,000 factories.
- The area has excellent infrastructure in the form of 20 power plants, two large deep sea ports and good transport connectivity to sea and air ports and to Bangkok.
- The area includes one of Thailand's largest tourist destinations, Pattaya. A ferry service across the Gulf of Thailand (which commenced in January) also now provides much faster access to Hua Hin, another established tourist destination.
- The EEC includes U-Tapao international airport, which has significant development potential (see below) and is close to Suvarnabhumi International airport.
- The EEC currently houses three universities and six technical colleges. The government envisages the establishment of further vocational training centres.

The government's aim is not only to make the EEC the best and most modern SEZ in ASEAN, but to grow existing industries and to attract new ones. Existing industries the government wants to uplift are next generation vehicles, smart electronics, medical wellness industry, agriculture and biotechnology. New industries the government seeks to encourage are robotics, as a medical hub, aviation repair and maintenance, biofuels and biochemical and disruptive technology.

The aim is to grow existing industries and to attract new ones

They envisage investment in both *hard* and *soft* infrastructure. The latter is new and would be the most radical development of all. It is also something which probably would not be possible without Thailand's unusual current political structure.

Investment in both *hard* and *soft* infrastructure

Planned investment in *hard* infrastructure

- Expansion of the deep sea port at Laem Chabang (cost: US$1bn)
- Expansion of the Map Ta Phut Industrial Port (cost: US$290m).
- A new double track railway to Map Ta Phut Port (cost: US$1.8bn)
- A high-speed train from Bangkok to Rayong (cost: US$4.5bn)
- A new motorway to Map Ta Phut (cost: US$580m)
- Expansion of passenger capacity of U-Tapao airport from 800,000 arrivals per annum to 3m, and
- Further zoning and lease of part of U-Tapao airport to a commercial aircraft manufacturer as a centre for maintenance and repair of aircraft.

Planned investment in *soft* infrastructure

- To pass Thailand's first ever area–specific law granting special authority to these three provinces in the area of industrial policy, trade facilitation and financial services. The government referred to something akin to the 'Shanghai Free Trade Zone'.
- The Board of Investment would be authorised to grant additional tax incentives to attract companies to establish in this SEZ, over and above what they could offer companies who established anywhere else in Thailand.
- The area should include a 'Global Business Hub'. Companies established in this centre would not be required to convert any overseas earnings into Thai Baht. It would effectively operate as an offshore financial centre.

In other words, in addition to push factors such as geo-politics and changing competitiveness which could incentivise companies (Chinese or otherwise) to invest in Thailand, there would be pull factors in the form of excellent infrastructure (both hard and soft) and financial incentives.

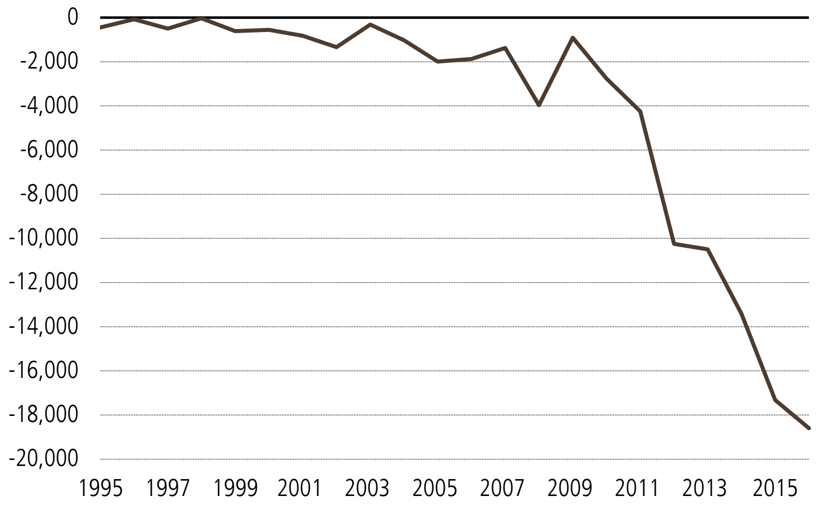
The larger picture, a potential hollowing out of Thai SMEs?

In future years, it seems likely that Thai companies would anyway be increasingly competing with their Chinese peers. These could be either new investors from China in Thailand, or it could simply be Chinese companies who choose to sell into Thailand. Change in Sino-Us relations under the new US administration could accelerate this.

Change is coming. For Thai companies, doing nothing is not an option, we believe

The scale of the challenge is evident from the chart below. Thailand's trade deficit with China between 1995 and 2009 averaged US$1bn. Based on annualised data for the first 11 months of 2016, this has expanded to US$19bn.

Figure 32: Thai trade balance with China, 1995 – 11M2016 (US$m)



Source: Bank of Thailand, UBS

An urgency to invest in technology and brands; to build 'deep moats"

This poses a potential threat to Thai companies, especially those SMEs who lack a brand or other significant barrier to entry. Those companies which prosper should be either those which complement new Chinese entrants (e.g. as suppliers of goods or more likely services) or those which are able to differentiate themselves either by investment in new technology or brand. Either way, we believe the government's offer to subsidise investment through tax credits is timely, and in our opinion, necessary. 'Business as usual' is not likely to be an option.

What is the net impact for our outlook for Thailand and how should investors position for these changes?

Our most preferred stocks feature many names which should benefit from an increase in investment, particularly banks and property. Conversely, our least preferred are more skewed towards domestic consumption, which after a strong 2016, we believe should underperform over the next 12 months.

Figure 33: Most and least preferred Thai stocks

	BBG Code	Rating	Mkt cap (US$ m)	Price (Bt.)	Core PE (x) 2017E	2018E	Div. Yield 2017E	P/BV 2017E	ROE FY17E	PT (Bt.)
Most preferred										
IRPC	IRPC.BK	Buy	3,069	5.3	12.3	10.4	4.1%	1.3	10.7%	6.1
Kasikornbank	KBANK.BK	Buy	12,716	187.50	12.1	10.6	2.1%	1.3	11.2%	196.00
PTT Public	PTT.BK	Buy	33,832	418.00	11.0	11.5	3.1%	1.4	13.6%	443.00
Siam Cement	SCCC.BK	Buy	17,546	516.00	12.6	12.6	3.2%	2.3	19.6%	570.00
Sino-Thai Eng.	STEC.BK	Buy	1,063	24.60	29.0	21.0	1.4%	3.5	12.6%	30.40
Supalai	SPALI.BK	Buy	1,192	24.50	7.2	6.4	5.5%	1.6	23.4%	30.40
TMB Bank	TMB.BK	Buy	2,862	2.32	11.5	9.4	2.6%	1.1	10.2%	2.40
Total Access	DTAC.BK	Buy	2,852	42.50	46.4	9.7	1.1%	2.8	7.8%	48.00
Least preferred										
Bumrungrad Hospital	BH.BK	Sell	3,731	181.00	34.2	30.5	2.0%	8.4	25.6%	166.00
Home Product Center	HMPRO.BK	Sell	3,876	10.40	32.4	28.9	2.7%	7.8	24.3%	7.70
LPN Development	LPN.BK	Sell	535	12.80	16.0	9.7	3.4%	1.5	9.3%	8.50
Thai Airways	THAI.BK	Sell	1,385	22.40	11.4	8.6	0.0%	1.2	11.0%	22.00
Thai Oil	TOP.BK	Sell	4,191	72.50	10.3	14.2	4.4%	1.3	13.0%	67.00

Note: data based on closing prices on 27 January 2017
Source: UBS estimates

Valuation Method and Risk Statement

There are many uncertainties in equity investing but, generally, economic and policy surprises are the most constant risks. Economic growth can be volatile, leading to earnings uncertainty. Inflation can likewise lead to interest rate volatility. The direction and level of policy rates have a substantial impact on equity valuations. Political events can also impact growth and risk premiums significantly.

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Buy	FSR is > 6% above the MRA.	45%	29%
Neutral	FSR is between -6% and 6% of the MRA.	39%	27%
Sell	FSR is > 6% below the MRA.	15%	16%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 December 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
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Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Bumrungrad Hospital Public Company	BH.BK	Sell	N/A	Bt181.00	27 Jan 2017
Home Product Center	HMPRO.BK	Sell	N/A	Bt10.40	27 Jan 2017
IRPC	IRPC.BK	Buy	N/A	Bt5.30	27 Jan 2017
Kasikornbank[7]	KBANK.BK	Buy	N/A	Bt187.50	27 Jan 2017
LPN Development	LPN.BK	Sell	N/A	Bt12.80	27 Jan 2017
PTT Public Company Ltd.[5]	PTT.BK	Buy	N/A	Bt418.00	27 Jan 2017
Siam Cement	SCC.BK	Buy	N/A	Bt516.00	27 Jan 2017
Sino-Thai Engineering & Construction PCL	STEC.BK	Buy	N/A	Bt24.60	27 Jan 2017
Supalai PCL	SPALI.BK	Buy	N/A	Bt24.50	27 Jan 2017
Thai Airways	THAI.BK	Sell	N/A	Bt22.40	27 Jan 2017
Thai Oil	TOP.BK	Sell	N/A	Bt72.50	27 Jan 2017
TMB Bank[7]	TMB.BK	Buy	N/A	Bt2.32	27 Jan 2017
Total Access	DTAC.BK	Buy	N/A	Bt42.50	27 Jan 2017

Source: UBS. All prices as of local market close.
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